

CHAPTER I

INTRODUCTION

1.1 Background of Study

Globalization has a huge impact in various aspect of life, one of which is in economic development. The development of economy, especially in terms of investment, both domestic and foreign, has resulted in the occurrence of cross-border transaction (Wardani & Kurnia, 2018). This makes the sales of goods, services and other financial transactions not centralized only in one country but also between companies in different countries where these activities involve multinational companies (Ondrusova, 2016).

The increasing of multinational companies play a very important role for Indonesia. One of the important roles is to increase regional and state revenue, especially in the contribution of tax revenue where the purpose is used to fund the public facilities in order to develop the country. However, many people or companies try to reduce the amount of tax to be paid by using some method which will lead to tax avoidance. The practice of tax suppression that most frequently used by multinational companies is transfer pricing.

Initially, transfer pricing is used to access the performance among company members or divisions. But nowadays, many multinational companies use the practice of transfer pricing to minimize their tax burden to be paid. According to Viviany (2018), transfer pricing results in a reduction or loss potential of tax revenue because multinational companies tend to shift their tax obligations by

lowering the selling price between companies in a same group and shifting profits to subsidiaries that located in other countries with lower tax rates.

In Indonesia, the regulations of transfer pricing are regulated in Income Tax Provision Law No.36 Year 2008 Article 18 concerning the relation between related parties, PMK 213/PMK.03/2016 concerning the types of documents and additional information about a transaction between related parties and Regulation of the Director General of Taxes Number PER-32/PJ/2011 concerning the application of Arm's Length Principle (ALP).

From the understanding above, it can be concluded that one of the factors in conducting transfer pricing is income tax. According to Fauziah and Saebani (2018), company carry out the practice of transfer pricing in their tax planning to reduce the amount of tax payment. As a result, the higher the income tax that is deferred by the company, the greater the transfer pricing practices in order to reduce the income tax payment. In this study, Effective Tax Rate (ETR) is used to measure income tax. Effective tax rate informs readers how aggressive a company in paying tax. The lower the percentage of effective tax rate, the smaller the tax payment. According to Hidayat et al., (2019), the smaller the tax payment made by the company, indicates that the company have conducted the practice of transfer pricing. The writer provides PT Bukit Asam Tbk with the code PTBA to explain more about Effective Tax Rate (ETR) toward Related Party Transaction (RPT).

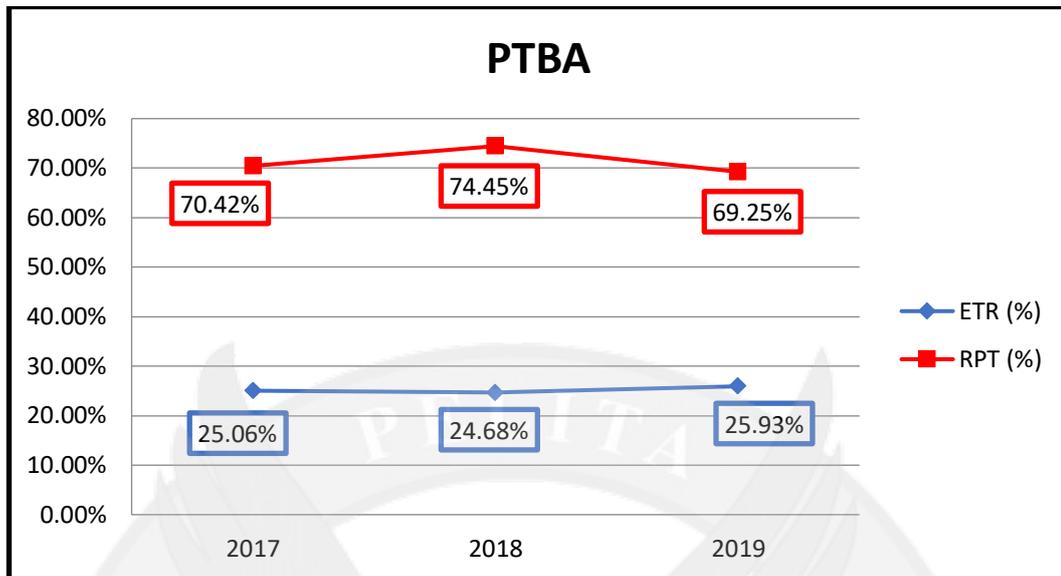


Figure 1.1 The Effect of ETR toward RPT in PT Bukit Asam Tbk for period 2017 - 2019

Source: Prepared by writer (2021)

From Figure 1.1 above, it can be seen that there were inconsistencies in the percentage of effective tax rate in 2017-2019, which also led to an inconsistencies in the percentage of related party transaction in 2017-2019. In addition, the percentage of effective tax rate increased from 24,68% in 2018 to 25,93% in 2019, also led the percentage of related party transaction decreased from 74,45% in 2018 to 69,25% in 2019. Moreover, the most significant factor of the increase in effective tax rate in 2019 was due to a decrease in profit before income tax as a result from the increase in cost of good sold in the period. This result supports the research of Klassen et al., (2016), which claimed that income tax partially had significant effect toward transfer pricing. This indicates that company with higher income tax has more potential on transfer pricing decision. However, it was different from the research conducted by Krisdianto et al., (2019) and Rathke et al., (2020) which claimed that income tax partially had no significant effect toward transfer pricing

decision. This indicates that no matter how much the amount of income tax that is deferred by the company, it does not affect a company decision in transfer pricing.

Another factors that affect a company on transfer pricing decision is leverage. According to Pratiwi (2018), the higher the leverage means that the higher potential of a company in transfer pricing decision, because there is possibility that leverage can act as a substitute for transfer pricing in achieving the reduction of corporate tax obligation. In this study, Debt to Equity Ratio (DER) is used to measure leverage. Debt to Equity Ratio (DER) is a comparison between the amount of debt and equity in order to see how far a company is being able to pay off their long-term debt. Usually, high leverage ratio of a company means that interest expense can be used to reduce the tax payment. The writer provides PT Elnusa Tbk with the code ELSA to explain more about Debt to Equity Ratio (DER) toward Related Party Transaction (RPT).

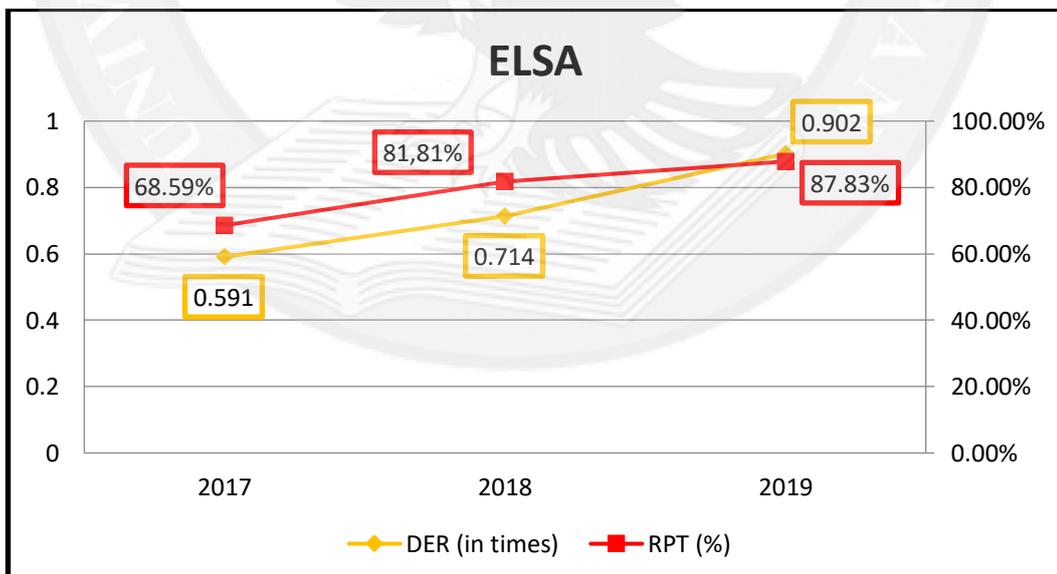


Figure 1.2 The Effect of DER toward RPT in PT Elnusa Tbk for period 2017-2019

Source: Prepared by writer (2021)

From Figure 1.2 above, it can be seen that debt-to-equity ratio increased significantly in 2017-2019. This led the percentage of related party transaction also increased significantly in 2017-2019. In addition, debt to equity ratio increased significantly from 0.714 in 2018 to 0.902 in 2019, which also led the percentage of related party transaction increased significantly from 81,81% in 2018 to 87,83% in 2019. Moreover, the most significant factor of the increase in debt-to-equity ratio in 2019 was due to an increase in liabilities as a result from the increase in the amount of long-term bank loans. This result supports the research of Anh et al., (2018) and Merle et al., (2019) which claimed that leverage partially had significant effect toward transfer pricing. This indicates that company with higher leverage has more potential on transfer pricing decision. On the other hand, research conducted by Sulistyowati and Kananto (2019) claimed that leverage partially had no significant effect toward transfer pricing. This indicates that no matter how much the amount of leverage, it does not affect a company decision in transfer pricing.

Besides income tax and leverage, transfer pricing also influences by company size. In this study, Ln (total assets) is used to measure company size. According to Rezky and Fachrizal (2018), company that is relatively larger have a greater pressure from their stakeholders and stockholders, so that the company performance must in line with the expectation of its investors, a better source of financing is needed in running the company. Usually, company that is relatively larger has more complex management system and also has higher income which this will encourage a company decision to carry out the practice of transfer pricing in order to reduce the tax payment. Therefore, larger companies that have a lot of

diversification of products or segment will have more tendency to encourage the practice of transfer pricing (Khotimah, 2018). The writer provides PT Samindo Resources Tbk with the code MYOH to explain more about Company Size toward Related Party Transaction (RPT).

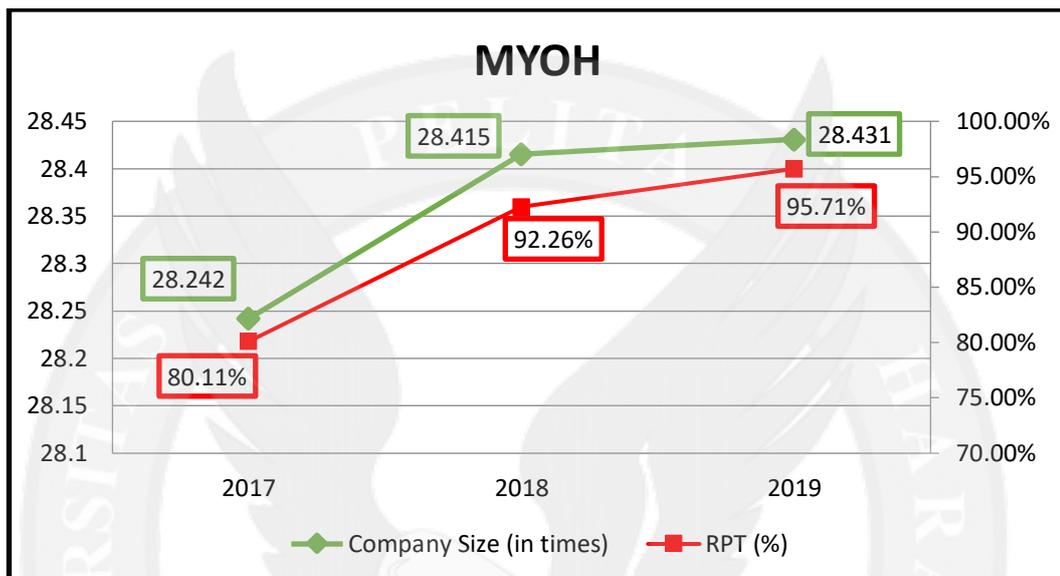


Figure 1.3 The Effect of Company Size toward RPT in PT Samindo Resources Tbk for period 2017 - 2019

Source: Prepared by writer (2021)

From Figure 1.3 above, it can be seen that the amount of company size increased in 2017-2019, this also led the percentage of related party transaction increased in 2017-2019. In addition, the value of company size slightly increased from 28.242 in 2017 to 28.415 in 2018, which also led the percentage of RPT slightly increased from 80.11% in 2017 to 92.26% in 2018. Moreover, the most significant factor of the increase in company size in 2018 was due to an increase in the amount of cash as the result from the increase of cash receipts from customers which lead to the increase in the total assets. This result supports the research of Richardson et al., (2013) and Waworuntu and Hadisaputra (2016), which claimed that company size partially had significant effect toward transfer pricing decision.

This indicates that company that is relatively larger has more potential on transfer pricing decision. Meanwhile, research conducted by Refgia (2017) claimed that company size partially had no significant effect toward transfer pricing decision. This indicates that no matter how much the amount of company size, it does not affect a company decision in transfer pricing.

This research is done in mining industry registered at Indonesia Stock Exchange. The writer selects mining industry as the research object because mining industry is one of the important tax contribution to the state. Another reasons to select mining industry is because mining industry have a lot of external companies connection with foreign holding companies and most of the investment in mining industry is domiciled by foreign investment, where this relationship or activities can cause a problem regarding transfer pricing due to the differences in a tax rate of each country.

Based on the background above, there are inconsistencies between one research and another research. Due to that case, the writer is motivated to conduct a research to know whether income tax, leverage and company size have an effect toward transfer pricing decision. The writer will test again with the title "**The Effect of Income Tax, Leverage and Company Size toward Transfer Pricing Decision in Mining Companies Listed at Indonesia Stock Exchange**".

1.2 Problem Limitation

There are some problem limitation made by the writer, namely:

1. The research object is mining companies listed at Indonesia Stock Exchange for the period of 2015-2019.
2. The independent variables are income tax, leverage and company size and the dependent variable is transfer pricing.
3. In this research, the measurement of income tax is using effective tax rate, leverage is using debt to equity ratio, company size is using Ln (total assets), and transfer pricing is using related party transaction.

1.3 Problem Formulation

The problem formulation made by the writer are as follows:

1. Does income tax partially have significant effect toward transfer pricing decision in mining companies listed at Indonesia Stock Exchange?
2. Does leverage partially have significant effect toward transfer pricing decision in mining companies listed at Indonesia Stock Exchange?
3. Does company size partially have significant effect toward transfer pricing decision in mining companies listed at Indonesia Stock Exchange?
4. Does income tax, leverage and company size simultaneously have significant effect toward transfer pricing decision in mining companies listed at Indonesia Stock Exchange?

1.4 Objective of The Research

The research objectives made by the writer are as follows:

1. To know whether income tax partially has significant effect toward transfer pricing decision in mining companies listed at Indonesia Stock Exchange.
2. To know whether leverage partially has significant effect toward transfer pricing decision in mining companies listed at Indonesia Stock Exchange.
3. To know whether company size partially has significant effect toward transfer pricing decision in mining companies listed at Indonesia Stock Exchange.
4. To know whether income tax, leverage and company size simultaneously have significant effect toward transfer pricing decision in mining companies listed at Indonesia Stock Exchange.

1.5 Benefit of The Research

This research is expected to provide benefits for various parties related to the research topic, including:

1.5.1 Theoretical Benefit

The results of this research are expected to be useful for other researchers as knowledge material to deepen and broaden insights in the field of taxation and accounting especially regarding the effect of income tax, leverage and company size toward transfer pricing decision. Furthermore, this research is intended as a reference and information for other researchers to review the issues related to transfer pricing.

1.5.2 Practical Benefit

1. The results of this research are expected to be a consideration for companies to be aware on the practice of transfer pricing and also related to the factors that probably have an effect toward transfer pricing decision, especially regarding the effect of income tax, leverage and company size on transfer pricing decision.
2. The results of this research are expected in increasing knowledge and giving information to investor about the effect of income tax, leverage and company size toward transfer pricing decision.
3. The results of this research are expected to be an input or consideration for Directorate General of Taxes about the effect of income tax, leverage and company size toward transfer pricing decision.

